UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Sithe Edgar LLC Docket No. ER00-3691-000
Sithe New Boston LLC
Sithe Framingham LLC
Sithe West Medway, LLC
Sithe Wyman LLC
AG-Energy, L.P.
Power City Partners, L.P.
Seneca Power Partners, L.P.
Sterling Power Partners, L.P.
Sithe Power Marketing, L.P.
Sithe Power Marketing, Inc.

(Issued November 21, 2000)

MASSEY, Commissioner, concurring:

I am concurring to highlight NSTAR's concern regarding market power in a subregion of NEPOOL. NSTAR points out that this Commission approved Sithe's market based pricing authority on the basis of what is known as the hub-and-spoke analysis that identified NEPOOL as the relevant market.[1] We approved market based rates to allow NEPOOL as a whole to operate bid-based energy and ancillary services markets based on an analysis that also identified NEPOOL as the relevant market. The Commission noted, however, that market power could be a problem to the extent that the region begins to experience transmission constraints.[2]

NSTAR points out that transmission congestion now has become a problem in NEPOOL and that the Sithe's affiliated generating companies may have market power in the Northeastern Massachusetts Area when congestion arises between this area and NEPOOL as a whole. NSTAR alleges that Sithe controls about 60% of the generating capacity within the Northeastern Massachusetts Area and that Sithe and one other supplier control about 85%. NSTAR wants the Commission to reject Sithe's market based pricing authority in this docket and require Sithe to demonstrate that it does not have market power during periods of congestion.

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[1]Sithe New England Holdings LLC, 83 F.E.R.C. ¶ 61,035 (1998).

[2]See New England Power Pool, 85 F.E.R.C. ¶ 61, 379 (1998).

I agree with the draft order that the filing in this docket is not the right forum to address this issue. However, I would like to make two additional points.

First, the information that NSTAR has brought to this record piques my concern. One lesson that I've learned from our experiences with electricity markets this past summer is that we would do well to heed danger signs as soon as they are visible. Waiting until prices become exorbitant, and customers are forced to pay unreasonable prices with no recourse, is not acceptable. Nevertheless, while I believe that NSTAR has raised an important concern, it has not yet made a sufficient case. If NSTAR chooses to go forward, I would encourage NSTAR to marshal its evidence and present us with a complaint under section 206 of the Federal Power Act. This is the proper way to proceed with NSTAR's concern.

The second point is that the analytical basis on which a future complaint is decided must be more sophisticated than the hub-and-spoke analysis. While I understand that most public utilities have justified their market based pricing authority by using this analytical method, I have come to believe that it is an anachronism. This method focuses solely on the market share of the individual seller instead of the conditions in the market. It assumes that all sellers that are directly interconnected with the customer, and all sellers directly interconnected with the applicant for market-based rates, can reach the market, and market shares are evaluated on that basis.

This is a back of the envelope approach, more or less. It takes little or no account of the important factors that determine the scope of electricity markets, such as physical limitations on market size including transmission constraints, prices, costs, transmission rates, and the variance of supply and demand over time. The hub and spoke is much too primitive for these times. Clearly, the Commission must develop a more sophisticated approach to market analysis, and I would recommend that we proceed generically to do so.

In recent orders, the Commission's focus has shifted from addressing solely individual sellers' market share to considering whether markets are functioning well and producing just and reasonable prices. I agree with this shift in focus. For example, in our California order,[3] we said that a dysfunctional market riddled with market flaws gave rise to market power and prices that are not just and reasonable. This is a bold step in the right direction. At some point, however, the Commission will have to operationalize and standardize a more generic analytic framework that focuses on market structure.

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[3]San Diego Gas & Electric Company, et at., 93 FERC ¶ 61,121 (2000).

I believe the concept of workable competition may be used. Workable competition has been defined as competition that leads to a reasonable or socially acceptable performance in the circumstances of a particular industry. Although the standard is somewhat vague and would have to be fleshed out, it is a pragmatic standard that takes into account the unique conditions of an industry. Let me suggest the kinds of issues that might be appropriate to consider in deciding whether a market is workably competitive, thereby justifying market-based pricing.

First, I would continue to look at market concentration, but surely not in the same way this measure is derived under the old hub-and-spoke method. Perhaps markets could be defined as we now define them for mergers under what is known as the Appendix A analysis.[4] The Appendix A approach moves in the right direction in that it considers energy prices, transmission capacity and transmission prices, all factors that can affect the scope of trade. This approach also takes account of the time dimension of supply and demand. By that, I mean that it is capable of analyzing horizontal slices of the supply curve at various load levels – such as peak, super peak, off peak and shoulder – to measure supplier concentration. Even more sophisticated approaches may be needed for assessing concentration in today's electricity markets.

But while concentration is a very useful statistic, I would not limit our market analysis merely to concentration issues. Various market monitor reports challenge us to look at market power in new ways. They have riveted our attention on a number of additional market structure issues. An analysis that seeks to determine if a market is workably competitive should look at the market structure and rules to determine if those rules create any perverse incentives or obstacles to market participants behaving in a competitive and efficient manner. We must look to see if the elements of a well functioning market are present. For example, the ability of customers to respond to price run ups by curtailing purchases is an effective check on the exercise of market power. If this demand responsiveness is lacking, I seriously doubt that we will see competitive outcomes from that market. By the same token, if meaningful hedging and forward contracting opportunities do not exist, we won't see competitive outcomes. If the market rules do not insist upon accurate scheduling, if there is over reliance upon the spot market, or if there is poor congestion management, competition will suffer and the market will not produce just and reasonable prices.

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[4]Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592,61 Fed. Reg. 68,595 (1996), FERC Statutes and Regulations ¶ 31,044 (1996), <u>reconsideration denied</u>, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement).

I am also convinced that computer simulation modeling will become essential to determining if markets are competitive. Such models can take into account the interaction of market structure, market rules and other market conditions such as demand responsiveness, to estimate behavior and the result on consumer prices. And after all, it is the results of markets that we are interested in. Modeling is used to some extent now in our merger analysis. I strongly encourage its continued development and increased use.

And as a last step in our market analysis, we should look at past behavior in the market. For example, past instances of successful withholding of supply to run up the price could be a clue to flaws in the market that were undetected by the first three areas of a inquiry I've suggested.

These are just some initial thoughts on how to put some "meat on the bones" of a new market analysis framework. These ideas are clearly not set in stone. I have been thinking of this problem for some time, however, and would now like to stimulate discussion and debate. My main point is that the Commission must redefine its standards for evaluating markets and market power. Our California remedies order moves in the right direction, but I would recommend that we address these issues by rulemaking or other generic processes.

There is another market power mitigation measure I would urge. As I've discussed on many occasions, RTOs are needed now. The uncertainty over grid organization is hamstringing markets in a number of ways. We can no longer be timid. As I said when we voted out Order No. 2000,[5] RTOs should be required.   We must insist that the horizontal and vertical market power mitigation potential of RTOs be fully implemented. Participation in an RTO should henceforth be a condition for FERC approval of any merger or application for market based rates. An RTO is a necessary element in a pro-competitive market structure.

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[5]See Regional Transmission Organizations, Order No. 2000, FERC Stats. & Regs. ¶ 31,089 (1999), 65 Fed Reg. 809 (January 6, 2000), order on reh'g, Order No. 2000-A, 90 FERC ¶ 61,201 (2000).

Getting back to the case at hand, I am concerned about NSTAR's allegations, but those allegations must be developed through a more sophisticated analysis in another proceeding.

For these reasons, I concur with today's order.

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William L. Massey